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[JOINT COMMITTEE PRINT]

PRESENT LAW AND ISSUES RELATING TO THE LOW-INCOME HOUSING AND REHABILITATION TAX CREDITS

SCHEDULED FOR HEARINGS

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

HOUSE COMMITTEE ON WAYS AND MEANS

ON MAY 23, 1989

AND

JUNE 6, 1989

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

MAY 12, 1989

U.S. GOVERNMENT PRINTING OFFICE

97-748 WASHINGTON : 1989 JCS-12-89

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

J 862-18
H782-14

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INTRODUCTION

The Subcommittee on Select Revenue Measures of the House Committee on Ways and Means has scheduled a hearing on May 23, 1989, on tax provisions affecting low-income rental housing. The Subcommittee has also scheduled a hearing on June 6, 1989, on provisions affecting the rehabilitation tax credit. This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of present-law tax provisions and a discussion of the tax issues relating to both the low-income housing and the rehabilitation tax credits.

The first part of the pamphlet is a summary. The second part describes the present-law provisions and discusses issues relating to the tax credit for low-income housing. The third part describes the present-law provisions and discusses issues relating to the rehabilitation tax credit.

Appendix A discusses economic issues relating to tax preferences for low-income rental housing. Appendix B provides an overview of Federal low-income rental housing assistance programs and utilization of the credit for rehabilitation expenditures.

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Present Law and Issues Relating to the Low-Income Housing and Rehabilitation Tax Credits* (JCS-12-89), May 12, 1989.

I. SUMMARY

Low-income housing tax credit

A tax credit may be claimed by owners of newly constructed, rehabilitated, and newly acquired existing residential rental property used for low-income housing. The credit is claimed annually, generally for a period of 10 years. For buildings placed in service after 1987, the credit percentages are adjusted monthly to provide a credit (over a 10 year period) with a present value equal to 70 percent of the qualified basis in the building. In the case of acquisition of existing housing and of newly constructed or rehabilitated housing receiving other Federal subsidies (including tax-exempt bonds), monthly adjustments are made to maintain a 30-percent present value for the credit.

The credit amount is based on the qualified basis of the housing units serving the low-income tenants. Low-income tenants for purposes of the low-income housing tax credit are defined as tenants having incomes equal to or less than either 50 percent or 60 percent of the area median income, adjusted for family size. An exception is provided for projects that elect to satisfy a stricter requirement and that significantly restrict the rents on the low-income units relative to the other residential units in the building (the "deep-rent skewing" set-aside). The qualifying income for a particular property depends on the minimum percentage of units that the owner elects to provide for low-income tenants. Rents that may be charged families in units on which a credit is claimed may not exceed 30 percent of the applicable qualifying income, also adjusted for family size.

To qualify for the credit, a low-income housing project must continuously comply with all requirements for the credit for a period of 15 years. Each State receives an annual credit volume limit of $1.25 per resident. A credit allocation from the appropriate State or local government credit authority must be received by the owner of the property eligible for the low-income housing tax credit, unless the property is substantially financed with the proceeds of tax-exempt bonds subject to the State's private activity bond volume limitation.

Tax credit for rehabilitation expenditures

Present law also provides an income tax credit for certain expenditures incurred in rehabilitating certified historic structures and certain nonresidential buildings placed in service before 1936. The amount of the credit is determined by multiplying the applicable rehabilitation percentage by the basis of the property that is attributable to qualified rehabilitation expenditures. The applicable rehabilitation percentage is 20 percent for certified historic structures and 10 percent for qualified rehabilitated buildings (other

than certified historic structures) that were originally placed in service before 1936.

A nonresidential building is eligible for the 10-percent credit only if the building is substantially rehabilitated and a specific portion of the existing structure of the building is retained in place upon completion of the rehabilitation. For this purpose, a building generally is considered substantially rehabilitated if the qualified rehabilitation expenditures incurred during a 24-month measuring period exceed the greater of (1) the adjusted basis of the building as of the later of the first day of the 24-month period or the beginning of the taxpayer's holding period for the building, or (2) $5,000. A building satisfies the structural requirement only if (1) at least 50 percent of the existing external walls of the building are retained in place as external walls, (2) at least 75 percent of the existing external walls of the building are retained in place as internal or external walls, and (3) at least 75 percent of the existing internal structural framework of the building is retained in place.

A residential or nonresidential building is eligible for the 20-percent credit that applies to certified historic structures only if the building is substantially rehabilitated (as determined under the eligibility rules for the 10-percent credit). In addition, the building must be listed in the National Register or the building must be located in a registered historic district and must be certified by the Secretary of the Interior as being of historical significance to the district.

II. TAX CREDIT FOR LOW-INCOME RENTAL HOUSING

A. Present Law

1. Tax credit for low-income rental housing—general rules

Overview

A tax credit may be claimed by owners of residential rental property used for low-income housing. The credit is claimed annually at a fixed rate, generally for a period of 10 years. For buildings placed in service after 1987, the credit percentages are adjusted monthly to provide a credit (over a 10 year period) with a present value equal to 70 percent of the qualified basis of the building. In the case of acquisition costs of existing housing and of newly constructed or rehabilitated housing receiving other Federal subsidies (e.g., financed by the sale of tax-exempt bonds), monthly adjustments to the credit percentage are made to provide a 30-percent present value for the credit.[2]

The credit is based on the qualified basis of the housing units serving the low-income tenants. Low-income tenants are defined as tenants having incomes equal to or less than either 50 percent or 60 percent of area median income, adjusted for family size. The qualifying income for a particular property depends on the minimum percentage of housing units that the owner elects to provide for low-income tenants. Rents that may be charged families in units on which a credit is claimed may not exceed 30 percent of the applicable qualifying income also adjusted for family size.

The credit generally is claimed in equal annual amounts during the first 10 years after the qualified property is placed in service.[3] However, unless the low-income housing project continuously complies with all requirements of the Internal Revenue Code for a period of 15 years a recapture of the credit is imposed.

Each State receives an annual credit volume limit of $1.25 per resident. A credit allocation from the appropriate State or local government credit authority must be received by the owner of property eligible for the low-income housing tax credit, unless the property is substantially financed with the proceeds of tax-exempt bonds subject to the State's private activity bond volume limitation.

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[2] New construction and rehabilitation expenditures for most low-income housing projects placed in service in 1987 were eligible for a maximum 9-percent credit per year for 10 years. The acquisition cost of existing projects and the cost of newly constructed projects receiving other Federal subsidies placed in service in 1987 were eligible for a maximum 4-percent credit per year for 10 years.

[3] A credit percentage equal to two-thirds of the credit percentage for the initial qualified basis is applicable to additions to qualified basis, as discussed below.

Determination of credit amount

The credit amount for low-income housing in any taxable year is computed by applying the appropriate credit percentage to the qualified basis amount for that year.

Credit percentage

For buildings placed in service after 1987, the credit percentage is determined monthly, to achieve a present value of either 70 percent (most newly constructed and rehabilitated buildings) or 30 percent (existing buildings and all Federally subsidized buildings) of the qualified basis. The present value is calculated as of the last day of the first year of the 10 year period for which the credit is allowed. The discount rate used to determine the present value is 72 percent of the average of the annual applicable Federal rates (AFR) for mid-term and long-term obligations applicable for the month the building is placed in service.[4]

Present law permits a building owner, with the consent of the applicable housing credit agency, to elect irrevocably to use the credit percentage for the month in which the taxpayer receives a binding commitment for a credit allocation from the credit agency or, in the case of a tax-exempt bond financed project for which no allocation is required, the month in which the tax-exempt bonds are issued.

The credit percentage for rehabilitation expenditures (in excess of a prescribed minimum amount) is determined when rehabilitation is completed and the rehabilitated property is placed in service.

Qualified basis

In general.—The qualified basis amount with respect to which the credit is computed is determined as the percentage of eligible basis in a qualified low-income building attributable to the low-income rental housing units. This percentage is the lesser of (1) the percentage of low-income units to all residential rental units or (2) the percentage of the floor space of the low-income units to the floor space of all residential rental units. In these calculations, low-income units generally are those housing units actually occupied by low-income tenants, whereas residential rental units are all housing units, whether or not occupied.

The qualified basis for each building is determined on the last day of each taxable year, beginning in the taxable year in which the building is placed in service or, if the taxpayer elects, the following taxable year.

Additions to qualified basis.—The qualified basis of a building may be increased subsequent to the initial determination only by reason of an increase in the number of low-income units or in the floor space of the low-income units (as contrasted to by reason of

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[4] Treasury's monthly adjustments of the credit percentages are to be determined on a discounted after-tax basis, based on the average of the annual applicable Federal rates (AFR) for mid-term and long-term obligations for the month the building is placed in service. The after-tax interest rate is to be computed as the product of (1) the average AFR and (2) .72 (one minus the maximum individual Federal income tax rate). The discounting formula assumes each credit is received on the last day of each year and that the present value is computed as of the last day of the first year.

increases in the eligible basis of the building). Credits claimed on such additional qualified basis are determined using a credit percentage equal to two-thirds of the applicable credit percentage allowable for the initial qualified basis. As described below under the description of the State credit ceiling, an allocation of credit authority must be received for credits claimed on additions to qualified basis, in the same manner as for credits claimed on the initial qualified basis. Unlike credits claimed on the initial qualified basis, credits claimed on additions to qualified basis are allowable annually for the portion of the required 15-year compliance period remaining after eligibility for such credits arises, regardless of the year such additional qualified basis is determined. The additional qualified basis is determined as a percentage increase in the original adjusted basis (before deductions for depreciation) of the property.

Eligible basis

In general.—Eligible basis consists of (1) the cost of new construction, (2) the cost of rehabilitation, or (3) the cost of acquisition of existing buildings acquired by purchase (including the cost of rehabilitation, if any, to such buildings incurred before the close of the first taxable year of the credit period and which do not exceed $2,000 per unit). Only the adjusted basis of depreciable property may be included in eligible basis. The cost of land is not included in eligible basis.

Generally, the eligible basis of a building is determined at the time the building is placed in service. For this purpose, rehabilitation expenditures (in excess of $2,000 per unit) are treated as placed in service at the close of the period when rehabilitation expenditures are incurred, not to exceed 24 months. In the case of rehabilitation expenditures incurred in connection with the acquisition of an existing building (and which do not exceed the $2,000 threshold amount), capital expenditures incurred through the end of the first year of the credit period may be included in the original eligible basis.

Acquisition of existing buildings.—The cost of acquisition of an existing building may be included in eligible basis and any rehabilitation expenditures to such a building incurred before the close of the first year of the credit period may at the election of the taxpayer also be included in eligible basis, without a minimum rehabilitation requirement. These costs may be included in eligible basis, however, only if the building or a substantial improvement to the building has not been previously placed in service within 10 years and if the building (or rehabilitated property within the building) is not subject to the 15-year housing credit compliance period.

A building that is transferred in a transaction where the basis of the property in the hands of the new owner is determined in whole or part by the adjusted basis of the previous owner (for example, by a gift of property) is considered not to have been newly placed in service for purposes of the 10-year placed-in-service requirement. Further, a building which has been acquired by a governmental unit, or certain qualified 501(c)(3) or 501(c)(4) organizations is not treated as placed in service by that governmental unit or organization for purposes of the 10-year placed-in-service requirement, if

the acquisition occurred more than 10 years from the date the building or a substantial improvement to the building was last placed in service. Further, a building acquired by foreclosure by taxpayers other than a governmental unit or 501(c)(3) organization is not treated as newly placed in service by that taxpayer for purposes of the 10-year requirement if the foreclosure occurred more than 10 years from the date the building or a substantial improvement to the building was last placed in service and the property was resold within a short period.

The Treasury Department may waive the 10-year requirement for any building substantially assisted, financed, or operated under the Department of Housing and Urban Development (HUD) Section 8, Section 221(d)(3), or Section 236 programs, or under the Farmers' Home Administration (FmHA) Section 515 program when an assignment of the mortgage secured by property in the project to HUD or FmHA otherwise would occur or when a claim against a Federal mortgage insurance fund would occur.

Federal grants and other subsidies.—Eligible basis may not include the amount of any Federal grant, regardless of whether such grant is included in gross income. If any portion of the eligible basis attributable to new construction or to rehabilitation expenditures is financed with Federal subsidies (e.g., tax-exempt bonds), the qualified basis is eligible only for the 30-percent present value credit, unless such Federal subsidies are excluded from eligible basis.

Minimum set-aside requirement for low-income individuals

In general

A residential rental project qualifies for the low-income housing tax credit only if (1) 20 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 50 percent or less of area median income or (2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 60 percent or less of area median income. These income levels are adjusted for family size.[5] (This requirement is referred to as the "minimum set-aside" requirement.)

A special set-aside may be elected for projects that satisfy a stricter requirement and that significantly restrict the rents on the low-income units relative to the other residential units in the building (the "rent skewing" set-aside). Projects qualify for this rule only if, as part of the general set-aside requirement, 15 percent or more of all low-income units are occupied by individuals having incomes of 40 percent (rather than 50 percent or 60 percent) or less of area median income, and the average rent charged to tenants in the residential rental units which are not low-income units is at least 300 percent of the average rent charged to low-income tenants for comparable units. Under this special rule, a low-income tenant who initially meets the 40 percent test will continue to qual-

[5] A special set-aside requirement under which a project qualifies if 25 percent or more of the units are occupied by individuals with incomes of 60 percent or less of area median income is provided for New York City.

ify in the future as such, as long as the tenant's income does not exceed 170 percent (rather than the general 140 percent limit, described below) of the qualifying income. Additionally, if a project to which this special set-aside requirement applies ceases to comply with the continuous compliance requirement because of increases in existing tenants' incomes, no penalties are imposed if each available low-income unit (rather than each available unit) is rented to tenants having incomes of 40 percent or less of area median income, until the project is again in compliance.

All units comprising the minimum set-aside in a project must be suitable for occupancy and used on a nontransient basis, and are subject to the limitation on gross rent charged to residents of set-aside units.

The owner of each project must irrevocably elect the minimum set-aside requirement (including the rent skewing set-aside described above) at the time the project is placed in service. In the case of a project consisting of a single building, the set-aside requirement must be met within 12 months of the date the building (or rehabilitated property) is placed in service, and complied with continuously thereafter for a period ending 15 years after the first day of the first taxable year in which the credit is claimed. Special rules apply to projects consisting of multiple buildings placed in service on different dates.

Continuous compliance required

The determination of whether a tenant qualifies as low income for purposes of the minimum set-aside requirement is made on a continuing basis, both with regard to the tenant's income and the qualifying area income, rather than only on the date the tenant initially occupies the unit. An increase in a tenant's income may result, therefore, in a unit ceasing to qualify as occupied by a low-income person. However, a qualified low-income tenant is treated as continuing to be such notwithstanding *de minimis* increases in his or her income. Under this rule, a tenant qualifying when initially occupying a rental unit will be treated as continuing to have such an income provided his or her income does not increase to a level more than 40 percent in excess of the maximum qualifying income, adjusted for family size. If the tenant's income increases to a level more than 40 percent above the otherwise applicable ceiling (or if the tenant's family size decreases so that a lower maximum family income applies to the tenant) that tenant is no longer counted in determining whether the project satisfies the set-aside requirement. No penalty is assessed in such an event, however, provided that each residential rental unit that becomes vacant (of comparable or smaller size to the units no longer satisfying the applicable income requirement) is rented to low-income tenants until the project is again in compliance.

Vacant units, formerly occupied by low-income individuals, may continue to be treated as occupied by qualified low-income individuals for purposes of the set-aside requirement (as well as for determining qualified basis) provided reasonable attempts are made to rent the units and no other units of comparable or smaller size in the project are rented to nonqualifying individuals.

Gross rent limitation

The gross rent paid by families in units on which a tax credit is claimed may not exceed 30 percent of the applicable area income qualifying as "low," adjusted for family size. Gross rent includes the cost of any utilities, other than telephone. If any utilities are paid directly by the tenant, the maximum rent that may be paid by the tenant is reduced by a utility allowance prescribed by the Treasury Department.

The gross rent limitation applies only to payments made directly by the tenant. For example, any rental assistance payments made on behalf of the tenant, such as through Section 8 of the United States Housing Act of 1937 or any comparable Federal rental assistance, are not included in gross rent for purposes of the 30-percent limit. (Such payments are, however, included in determining gross rent for purposes of the special exception for rent-skewed projects.)

Compliance period and penalty for noncompliance

Qualified residential rental projects must remain as rental property and must satisfy the minimum set-aside requirement, described above, throughout a 15-year compliance period. Units on which credits are claimed in addition to those meeting the minimum set-aside requirement on which a credit is allowable also must continuously comply with this requirement.

Generally, any change in ownership of a building subject to the compliance period is a recapture event. An exception is provided if the seller posts a bond with the Treasury Department (in an amount prescribed by Treasury) and provided it can reasonably be expected that the building will continue to be operated as a qualified low-income building for the remainder of the compliance period. For partnerships comprised of at least 35 individual partners, unless the partnership elects otherwise, no change in ownership will be deemed to occur provided that within any 12-month period, at least 50 percent (in value) of the original ownership is unchanged.

If any building subject to the 15-year compliance period fails to remain part of a qualified low-income project, a portion of all credits claimed is recaptured with interest for all prior years and the qualified basis of the building is reduced.

Similarly, in the event of a decrease in the qualified basis of a building, while still remaining part of a qualified low-income project, (e.g., through a reduction in number of qualified low income units) there is recapture of the credits with respect to the accelerated amount claimed for all previous years on the amount of the reduction in qualified basis plus interest.

Owners and operators of low-income housing projects on which a credit has been claimed may correct any noncompliance with the set-aside requirement within a reasonable period after the noncompliance is discovered or reasonably should have been discovered. If the taxpayer can correct the noncompliance in the manner required, there is no recapture.

State low-income housing credit authority limitation

In general

Generally, all buildings eligible for the low-income housing credit must receive an allocation of credit authority from the State or local credit agency in whose jurisdiction the qualifying low-income housing project is located. The aggregate amount of such credits allocated within the State is limited by the State annual low-income credit authority limitation. Generally, credits subject to the State credit authority limitation include any credits attributable to expenditures not financed with tax-exempt bonds subject to the private activity bond volume limitation.

In all cases, credit allocations are counted against a State's annual credit authority limitation for the calendar year in which the credits are allocated. Credits may be allocated only during the calendar year in which the building or rehabilitated property is placed in service, except in the case of (1) credits claimed on additions to qualified basis and (2) credits allocated in a later year pursuant to an earlier binding commitment made no later than the year in which the building is placed in service.

Present law permits a building to be placed in service in the year in which the credit allocation is received or in either of the two succeeding years provided that at least 10 percent of the expected project costs were paid by the end of the year in which the credit allocation was received. This provision applies only to credit allocations for new construction and substantial rehabilitations.

Project costs are the total costs budgeted to acquire and develop the project. These costs include costs budgeted by the taxpayer to acquire the land and any existing structure. The determination of whether the taxpayer has incurred at least 10 percent of the total project costs is measured by calculating the following fraction. The numerator of the fraction is the taxpayer's basis (land and depreciable basis) in the property as of the close of the calendar year in which the credit allocation is made by the State authority. The denominator of the fraction is the taxpayer's reasonably expected basis (land and depreciable basis) in the property at the time the property is placed in service.

Allowable credit authority

General rules.—The annual credit authority limitation for each State is equal to $1.25 for every individual who is a resident of the State. For purposes of the credit authority limitation, the District of Columbia and U.S. possessions (e.g., Puerto Rico, the Virgin Islands, Guam, and American Samoa) are treated as States. No credit authority is provided for years after 1989.

Special set-aside for qualified nonprofit organizations.—A portion of each State's credit authority limitation is set aside for exclusive use by qualified nonprofit organizations. This set-aside is equal to $0.125 per resident of the State. This set-aside amount may not be decreased by State action, either legislative or gubernatorial. In addition to the special set-aside, qualified nonprofit organization projects may be allocated any additional amount of a State's remaining credit authority.

For these purposes, a qualified low-income housing project must have the material participation of a qualified nonprofit organization in its development and operation. A qualified nonprofit organization means any organization (1) described in section 501(c)(3) or section 501(c)(4) of the Code and which is exempt from tax under section 501(a); and (2) one of the exempt purposes of such organization includes the fostering of low-income housing.

2. Other applicable restrictions on the tax credit for low-income rental housing

a. At-risk rules

Present law provides that the low-income housing credit is not allowed with respect to borrowed amounts that do not meet the requirements of the low-income housing credit at-risk rules (sec. 42(k)). The at-risk rules applicable to the low-income housing credit are a modified version of the generally applicable credit at-risk rules. In general, the credit at-risk rules as applicable for the low-income housing credit provide that nonrecourse debt is treated as an amount at risk where (1) it is borrowed from a commercial lender, or represents a loan from (or is guaranteed) by certain governmental entities; (2) the property is acquired from an unrelated person; (3) the lender is not a person from whom the taxpayer acquired the property (and is unrelated to such a person); (4) the lender or a related person does not receive a fee with respect to the taxpayer's investment in the property; and (5) the debt is not convertible debt.

In addition, under special rules, certain financing provided by qualified nonprofit organizations may be treated as an amount at risk for purposes of the low-income housing credit, without regard to whether the organization is actively and regularly engaged in the business of lending money, or is a person from which the taxpayer acquired the property (or is related to such a person). These special rules impose restrictions on who may hold a security interest in the property, on the portion of the property attributable to such financing, and on the repayment schedule and the interest rate of such financing, among other restrictions. The credit is recaptured if the financing provided by such organizations is not repaid with interest by the end of the 15-year credit compliance period.

b. Restrictions on deductions and credits arising from passive activities

Passive loss rules in general

The Tax Reform Act of 1986 added a provision limiting losses and credits from passive activities (i.e., activities in which the taxpayer does not materially participate, and rental activities).

Under this provision, deductions from passive trade or business activities or rental activities, to the extent they exceed income from all such passive activities (exclusive of portfolio income), generally may not be deducted against other income. Similarly, credits from passive activities generally are limited to the tax attributable to the passive activities. Suspended losses and credits are carried

forward and treated as deductions and credits from passive activities in the next year. Suspended losses from an activity are allowed in full when the taxpayer disposes of his entire interest in the activity.

The provision applies to individuals, estates, trusts, and personal service corporations. A special rule limits the use of passive activity losses and credits against portfolio income in the case of closely held corporations.

Special rules

$25,000 allowance in the case of rental real estate activities.—A special rule is provided for passive activity losses and credits attributable to rental real estate activities. In the case of rental real estate activities, a taxpayer who is an individual is allowed to deduct up to $25,000 of passive activity losses (to the extent that they exceed income from passive activities) if the taxpayer actively participates in the rental real estate activity (and has at least a 10-percent interest in it). The $25,000 amount is phased out ratably as the taxpayer's adjusted gross income, with certain modifications, increases from $100,000 to $150,000.

$25,000 allowance for low-income housing and rehabilitation credits.—Under a special rule, the $25,000 allowance also applies to low-income housing and rehabilitation credits (on a deduction-equivalent basis), regardless of whether the taxpayer claiming the credit actively participates in the rental real estate activity generating the credit. In addition, the adjusted gross income phaseout range for the $25,000 amount for these credits is from $200,000 to $250,000 (rather than the generally applicable phaseout range of $100,000 to $150,000).

Effective date

The passive loss limitations are effective for taxable years beginning after 1986. For certain pre-enactment interests in passive activities, the provision is phased in, and becomes fully effective for taxable years beginning in 1991 and thereafter. Transitional relief is provided for losses from certain existing low-income housing activities.

c. Restrictions on use of credit to offset tax

The low-income housing tax credit is subject to the rules of the general business credit (sec. 38), including the maximum amount of income tax liability that may be reduced by a general business credit in any one year. This limitation generally is equal to the excess (if any) of the taxpayer's net income tax over the greater of (1) the taxpayer's tentative minimum tax for the year, or (2) 25 percent of so much of the taxpayer's net regular tax liability as exceeds $25,000.

The rules for credit carryovers provide that unused credits for any taxable year may be carried back to each of the three preceding taxable years and then carried forward to each of the 15 following years. No portion of the low-income housing credit for any taxable year may be carried back to a taxable year ending before 1987 (sec. 39(d)(4)).

B. Issues Relating to the Low-Income Housing Tax Credit

1. Eligibility for the credit

a. 10-year placed-in-service requirement

Current treatment

The cost of acquisition and any rehabilitation expenditures with respect to a low-income building generally may be included in eligible basis only if two requirements are satisfied: (1) the building or a substantial improvement to the building may not have been previously placed in service within 10 years; and (2) the building or rehabilitated portion of the building may not already have been placed in service by the taxpayer or any person who was a related person with respect to the taxpayer as of the time previously placed in service.

One benefit of the 10-year placed-in-service requirement is that it operates to prevent the transfer and placement in service of buildings primarily for tax motivated reasons. This provision limits the ability of owners and investors in structures to receive multiple tax benefits from the same tax property. There is evidence that churning such property could have substantial tax effects.[6]

The Congress has identified specific instances in which exceptions are provided to the placed-in-service rule: (1) a placement in service is unlikely to be a purely tax-motivated transaction or (2) the absence of an exception from the placed-in-service rule could result in an assignment or other claim against the Federal Government or certain government sponsored entities. (This latter determination is made by the Department of the Treasury.)

Included in the first classification are placements in service in connection with the gift or inheritance of property. The second classification relates primarily to certain Federally assisted housing, where an assignment of the mortgage secured by property in the project to HUD or the Farmers Home Administration would occur or when a claim against a Federal mortgage insurance fund would occur.

Proposals for further exceptions from the 10-year placed-in-service requirement

Numerous proposals have been suggested to create exceptions to the 10-year placed-in-service requirement (see above). One such proposal would create an exception from the 10-year placed-in-service requirement for property on which a mortgage originates from the Federal Government or which is Federally insured or guaranteed but which receives no Federal assistance.

The Department of Housing and Urban Development (HUD) estimates that the Sections 221(d)(3) and 236 programs presently subsidize over 600,000 units of rental housing. HUD further estimates that mortgages on over 25 percent of these units are likely to be prepaid between now and the mid-1990s.[7] With prepayment of the

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[6] *See* Roger H. Gordon, James R. Hines, Jr., and Lawrence H. Summers, "Notes on the Tax Treatment of Structures", in Martin Feldstein (ed.), *The Effects of Taxation on Capital Formation* (Chicago: University of Chicago Press), 1987.

[7] See, G., Milgram, *The Assisted Housing Stock: Potential Losses from Prepayment and "Opt-outs"*, Congressional Research Service, Report 87-879E (November 4, 1987).

HUD-subsidized mortgage, HUD loses control of the rents that tenants may be charged. These housing units may be converted to nonsubsidized rental housing or owner-occupied housing as a result. This problem is less likely to occur for State-financed, nonFHA-insured projects which are subject to State control. Most, if not all, of these mortgages prohibit prepayment.[8]

One argument for the proposed exception is that selective use of the low-income housing credit for some of these housing projects could encourage their retention as subsidized rental housing (a goal of housing policy). Concomitantly, the tax credit's targeting rules would be extended to these projects, many of which currently qualify for these outlay provisions under more relaxed rules.

On the other hand, permitting waivers of the rule restricting tax credits to projects that have not been placed in service within the 10 years preceding the credit-eligible transfer may not be the most effective way to assure a stock of low-income rental housing. Much rental housing serving low-income households originally was not built as low-income housing. Rather, as the housing aged and more new housing was built, the older housing became affordable and available to low-income families. Expanding the circumstances under which waivers of the 10-year anti-churning rule may be granted by Treasury without imposing a substantial rehabilitation requirement may eliminate incentives to increase or improve the stock of low-income rental housing.

A second proposal would create an exception for property that is in default. It has been suggested that this type of exception would be particularly desirable if a State or local housing agency would take possession of the property as a result of the default.

Some argue that a natural extension of present law would be to grant the same waiver from the 10-year requirement to cases of default to State or local agencies that is currently available to cases of default involving some Federally-assisted projects which are at risk of default. Under this view, the State and local authorities would have more flexibility in allocating the credit and could use their available credit authority to generate the greatest stock of low-income housing regardless of its last placed-in-service date. Property at risk of conversion or of imposing losses on governmental bodies responsible for encouraging low-income rental housing hinders State and local housing officials from most effectively promoting utilization of low-income housing.

Others argue that the Federal Government has established a class of properties that are eligible for the low-income housing credit waiver. These projects were chosen with the rationale of permitting the Federal Government to substitute tax expenditures for budgetary outlays when this would provide a more attainable result. When the waiver is used to prevent default to State and local housing authorities, it is argued that the waiver is not being used to minimize Federal costs but instead serves as a subsidy from the Federal Government to the State or local governmental body. In this view, the waiver is inappropriate because the credit authority could be better utilized to generate new low-income units as op-

[8] *Ibid.*

posed to further subsidizing relatively new existing units or State governmental units or agencies.

To the extent that a State has unused credit authority available, the use of the credit on buildings which receive the waiver may increase low-income housing by preventing conversion or, alternatively, subsidizing the housing authority. However, if a State is already allocating the maximum credit available, then the use of credit authority on property receiving the waiver will displace other low-income housing property. The net impact on available housing depends on the relative increase provided by alternative projects. The stock of low-income housing in this situation may increase or decrease because of the availability of the waiver, but the net effect of the eligibility waiver for areas which are already allocating all credits may be small.

A third proposal would create an exception from the 10-year placed-in-service requirement for certain properties in the HUD inventory on which HUD is prepared to foreclose. Proponents of this exception assert that utilization of the low-income housing credit will avert a further revenue drain on HUD. Opponents respond that any savings to HUD would necessarily involve a tax expenditure drain on the general fund of the Treasury.

b. Type of buildings eligible for the credit

Level of credit—70 percent versus 30 percent

Present law provides a greater tax benefit for new buildings and substantial rehabilitation costs than for either existing buildings not involving substantial rehabilitation or tax-exempt bond financed buildings. One of the credit's objectives is to provide an incentive to expand and upgrade the nation's low-income housing stock by more than the private market alone would provide.

There are those who argue that the relatively scarce tax expenditure resources available through the credit should be directed solely at new construction and substantial rehabilitation projects. They argue that providing incentives targeted primarily to existing property will generate little net increase in rental housing for low-income populations. Instead, they contend that much of the benefit of the incentives for existing housing will go to owners of property which would have remained low-income anyway. Also, when an incentive is provided to keep existing property as low-income housing, such property may displace other new or rehabilitated housing possibly of better quality that might have become available to low-income populations. The particular level of tax incentive granted may bear little relation to the level of housing services provided by the project or the amount needed to assure the continued provision of low-income rental housing. Instead, the value of the proposed tax incentive to be granted depends on the particular historical pattern of investments associated with a property, in nominal rather than in inflation-adjusted dollars. Therefore, the benefit is only loosely related to age or the true worth of the project.

What constitutes substantial rehabilitation

The argument is made that the present law requirements as to what constitutes substantial rehabilitation are not stringent

enough. Currently, a property can qualify as a substantial rehabilitation project if qualified rehabilitation expenditures average $2,000 per unit. It is argued that in some instances this level of expenditure provides an inadequate level of improvement to the housing stock. Further, the value of the tax credit should require a higher level of required expenditures.

The counter argument is that the credit provides an important incentive to owners of existing property to initiate or continue its use as low-income property. The protection of a stock of low-income housing is especially important in light of the increasing demand for such housing and the reduction of direct Federal subsidies in recent years for such housing.

Because labor and material costs vary across the nation, any dollar limit for qualifying expenses may be stringent in some areas and lax in others. In part, to meet this concern it has been proposed that the $2,000 per unit average expenditure requirement be replaced. One alternative would require that qualified rehabilitation expenditures amount to a fixed percentage of the eligible basis in the acquired property.

Small owner-occupied buildings

In the case of a building with four or fewer units, no unit is a qualified low-income unit for purposes of the credit under present law if any units in that building are occupied by the owner or a related person. The definition for purposes of the credit generally follows the definition of single-family, owner-occupied residences used elsewhere in the Internal Revenue Code.

Some argue that eligibility for the credit should be extended to otherwise qualified units in such buildings that are not occupied either by the owner or a person related to the owner. They argue that a response to abusive uses of the credit can be more accurately targeted than through the denial of the credit to the entire building.

Opponents respond that a double tax subsidy may result when a building qualifies for tax benefits under both the low-income housing tax credit and the single-family mortgage revenue bond tax-exempt financing. An extension of credit eligibility to buildings with four or fewer units may have the result that certain buildings qualify for tax benefits under both provisions. It is further argued that smaller projects are less likely to need the operating subsidy the credit may represent due to generally lower costs of operation.

c. Duration of low-income use

The low-income housing credit requires that the project remain in compliance for 15 years, but accelerates the period over which the tax benefit is allowed to the taxpayer to the first 10 years. If the project falls into noncompliance, the accelerated portion of the credit plus interest is recaptured. Upon disposition of an interest in a credit property within the compliance period, the taxpayer must post a bond that represents the taxpayer's total recapture liability. One purpose of the bond requirement is to bolster the effectiveness of the recapture penalty in maintaining extended low-income use.

There are two major issues involving this aspect of the credit. The first issue is whether the compliance period should be extended or otherwise modified. The second issue is whether the complexity of the recapture mechanism unduly burdens the taxpayer and limits liquidity.

Those who support the extension of the compliance period cite the shortage of affordable housing for low-income individuals. They also draw an analogy to the experience of the Federal Government in Federal housing programs. Recent experience shows a conversion to market rate use of low- and moderate-income housing soon after the restrictions against such conversion lapse. It is also argued that, at a minimum, a mechanism should exist to allow the government an option to maintain the low-income use of the property before its conversion to market rate use.

Opponents argue that the benefit of the credit will not support a dramatically longer compliance period. Economically, the costs of construction and operation of such projects may be high relative to the combination of the tax benefit and the cash flow from the project. They further argue that the complexity of the bond posting mechanism is exacerbated by the length of the compliance period and by the number of transfers of ownership interests that occur.

One way to reduce the complexity of the credit would be to eliminate the requirement of posting a bond in the amount of recapture liability at the time of transfer of ownership interest. It is argued that the size of the bond may be large especially on transfers early in the compliance period (due to the interest component of the bond). The counterargument is that the bond is necessary to maintain the nexus between the taxpayer who received the accelerated tax benefit and the compliance of the low-income project. The only way to eliminate the need for the bond and maintain a direct nexus between the recipient of the tax benefit and the provision of low-income housing is to modify the credit so the credit period coincides with the compliance period (i.e., extend the credit period to 15 years).

One way to extend low-income use without compounding the complexity of the recapture requirement would be to impose a deed restriction on credit property. Such a restriction, enforceable under State law, would require that the property be maintained within a low-income use for some defined period of time after the credit compliance period. The State agencies or even the low-income individuals themselves would have the ability to enforce this right. Proponents argue that extended low-income use would result from such a proposal. Opponents argue that by reducing potential resale value any such restriction would reduce investor interest in credit properties and adversely affect liquidity of ownership interests.

d. Eligible tenants and services

Use by the general public

The legislative history of the credit includes a discussion of the requirement that residential rental units must be available for use by the general public. The term "use by the general public" was not defined in either the Tax Reform Act of 1986 or the legislative

history to that Act. The Internal Revenue Service has, however, released guidance on the subject.

Some argue that a comprehensive definition should be the subject of future legislative efforts. Legislation could, for example, clearly delineate allowable tenants and provide a bright line test for taxpayers. Others respond that a static definition would not satisfy the evolving concept of public use and no definition could provide an exhaustive list of eligible tenants. Legislation should be used to provide guidance to the IRS only as needed.

Significant services

Some low-income tenants are furnished services, other than housing, such as laundry, day care, and meals. The issue of services provided to tenants of credit properties was not comprehensively addressed at the time of enactment. Subsequently, this issue has been the subject of regulatory guidance by the IRS. In IRS Notice 89-6 (1989-2 I.R.B. 16)), the Service took the position that the furnishing to tenants of services other than housing (whether or not such services are significant) will not prevent the property from qualifying as residential rental property. Generally, any charges for services that are not optional to the low-income tenants and are paid for by the tenants must be included as rent for purposes of the gross rent limitation.

The elimination of the significant services standard has been advocated for two reasons: (1) reduction in complexity, and (2) recognition that certain elements of the low-income population require special social services. It is argued that the IRS position on this issue causes some projects to violate the rent restriction requirement of the credit. The ineligibility of hospitals, nursing homes, and sanitariums would remain unchanged from present law under the proposal. Opponents of such modifications argue that definitional vagaries would exist under any standard. Opponents also note that as the credit reaches full utilization, any expansion of use of the credit for special needs/special service housing reduces credit availability for other low-income families.

Non-transient use restriction

Unlike the requirements for units in projects financed with tax-exempt bonds, certain single room occupancy housing used on a nontransient basis may qualify for the credit even though such housing may provide eating, cooking and sanitation facilities on a shared basis. Generally a unit is considered to be used on a nontransient basis if the initial lease is six months or longer.

It is argued that the six-month initial lease term is necessary to target the benefits of the credit to the provision of traditional housing. The counterarguments are that the six-month rule is arbitrary and that it precludes availability of credit-subsidized housing to a significant portion of low-income individuals who need it.

e. Rent restrictions

30-percent of area median income rule

The credit limits the total allowable gross rent that low-income families must pay for housing subsidized by the credit. This is in

recognition of the fact that lower-income individuals have relatively less income to devote to housing costs. In fact, the gross rent paid by families in units on which a tax credit is claimed generally may not exceed 30-percent of the qualifying income (i.e., rent is limited to 30-percent of either 50 or 60 percent of area median income) adjusted for family size. The area median income figure is annually recomputed by HUD. Because the rent, restriction is based on qualifying income rather than the tenants actual income some families can pay more than 30-percent of their income in rental payments.

Two main issues have been raised regarding the 30-percent rule. The first consideration is whether the accuracy that could be attained by limiting gross rent to actual family income outweighs the additional administrative complexity. A second issue is whether other restrictions on allowable rent payments should be superimposed over the 30-percent of area median income limitation.

Actual family size versus standard measurements of income

Those who favor gross rent limitations based on actual family income argue that this standard more accurately reflects the ability of low-income families to pay rent. Opponents report that the administrative burden of computing this figure for each low-income family would outweigh the relative benefits. Opponents also argue that such a standard would produce uncertainty of cash flows to investors in credit properties.

Other restrictions

The need for certainty by investors in the rental income stream is the basis for a proposal to set the initial month's rent as a floor below which rents may not fall. It is argued that providing certainty to investors' cashflow may create greater investor interest. On the other hand, not requiring reductions in rent as area median incomes fall could impose a greater financial burden on the low-income tenants.

A related argument is that maximum rent should be determined on the size of the apartment rather than family size. This proposal also has the merits of simplicity and greater certainty of cashflow to investors. Again, it may result in a less accurate measurement of the tenant's ability to meet the rental obligations.

f. Other tax provisions relating to the operation of the low-income housing credit

Issues under the passive loss rules

Although present law does provide more liberal treatment for the low-income housing credit than for other tax benefits under the passive loss rules, some argue that the imposition of any restriction on the credit under the passive loss rules deter investment in low-income housing projects. It is argued that the incentive provided by the low-income housing credit is not fully utilized because many potential investors whose adjusted gross incomes exceed the $250,000 limit under the passive loss restrictions cannot receive any current benefit from the credit. Limiting utilization of the credit in this manner, it is argued, is inconsistent with the non-tax

policy for retaining the credit: i.e., to promote the development, construction and maintenance of low-income housing stock in the United States.

Others point to the growth in utilization of the credit since its institution only 3 years ago. They argue that, because the credit is already almost fully utilized under the State agency allocation caps, there is no need to expand the investor market. Utilization could not be increased because of the cap on the total available credits.

Those who favor broadening the investor market for the credit respond that, if there were more competition for investor dollars to be spent on low-income housing, the efficiency of the credit would be improved. More viable projects, and less marginal ones, would be developed if there were more competition for investor dollars.

Those who oppose altering the passive loss restrictions suggest that other changes in the administration of the credit could make it more efficient, without contradicting the purpose of Congress in enacting the passive loss restrictions generally: to limit tax shelters and to make sure that everyone pays a fair share of taxes. They argue that removing the passive loss restrictions on these credits would only increase tax benefits for the very wealthy and those with high incomes without significantly increasing the availability of low-income housing in the United States.

Income from discharge of indebtedness

It is common to finance plans involving both credit and noncredit transactions that a portion of the cost of the project is debt-financed. Generally, the existence of debt financing alone will not deny or restrict the ability of a taxpayer to receive tax benefits on such property. Typically, these loans are satisfied by payment of the amount due. If the lender instead forgives the indebtedness, the borrower may have taxable income from such discharge of indebtedness.

In an effort to encourage free marketability of debt-financed credit property, some argue that an exception from the discharge of indebtedness rules should be created. Others argue that such exception would encourage taxpayers to inflate the size of loans made in connection with the credit in order to inflate eligible basis and therefore the level of tax benefits. This abuse would be particularly troublesome in situations where at-risk rules are not fully applicable under the credit.

2. Role of the allocating agencies and State and local governments

a. Allocation plans and selection criteria

No administrative or allocation plans are required of the allocating agencies under the credit program. Current law could be amended to require allocating agencies to establish, publish, and hold hearings on allocation plans. Such plans would set forth the standards under which allocations would be made. Examples of selection criteria are location, housing needs, project characteristics, sponsor characteristics, housing mix, and financial participation in the projects by State or local governments.

One issue related to such proposals is whether allocation plans should be voluntary or mandatory to the allocating agencies and if mandatory, the penalty for noncompliance. A second issue is whether selection criteria should be determined by each allocating agency or rather by the Federal Government. These issues revolve around the relative importance assigned to the need for certain uniform standards and the value of added flexibility to the allocating agencies.

b. Project evaluation

Some have advocated a proposal to require State housing agencies responsible for allocating credit amounts to allocate on the basis of a specific project evaluation. As discussed above, the maximum credit amounts are (1) a 70-percent present value credit for new construction and substantial rehabilitation expenditures and (2) a 30-percent present value credit for certain existing buildings and Federally subsidized buildings. These credit amounts represent the maximum amounts permitted, but the allocating agency may set lower amounts for each project. Early experience with the credit indicates that the allocating agencies rarely allocate less than the maximum credit amount.

Proponents of a project evaluation process argue that allocating agencies should be required to exercise their authority to allocate the limited resources of the credit in the most efficient way possible. They assert that a formal, standardized project review process conducted by the allocating agency should be performed on each project. Opponents respond that market forces alone will lead to the most efficient utilization of the credit.

Two main issues have risen with respect to the concept of a project evaluation process. The first issue is whether the evaluation process should be mandatory for the allocating agencies, and, if so, what sanction would apply for failure to implement the process. The second issue is whether the selection criteria should be determined by the Federal Government or the allocating agencies themselves (see B.2.a., above).

An argument against a mandatory project evaluation program is the responsibility of the allocating agencies to take local concerns into consideration in the allocation process without the complexity of a formal process. Further, some agencies may not have the staff to conduct a comprehensive evaluation process. A counter argument is that delivery of the credit to those projects that most need it, as determined by a formal and objective set of criteria, outweighs the value of increased flexibility to the allocating agencies.

3. Utilization of the credit

a. Level of credit increasing annually since its inception

The low-income housing credit was enacted to replace several other tax incentives available but not directly targeted to low-income housing. Prior to the Tax Reform Act of 1986, no low-income rental housing credit existed. Preliminary data shows a utilization rate of 19 percent of allocable amounts in calendar year

1987. This level increased to nearly 70 percent in 1988, and is expected to approach full utilization in 1989.[9]

Generally, two reasons have been advanced for the utilization curve since the credit's inception: (1) increased taxpayer familiarity with the program; and (2) the 1988 modification to the credit that allows allocation currently for projects where at least 10 percent of the total reasonably expected project costs have been incurred, but where the project may not be placed in service until one of the next two succeeding years (the "10-percent test"). This modification did not extend to tax-exempt bond financed properties.

Some argue that levels of utilization are too low and that significant adjustments should be made to the credit to make it more attractive to investors. The response is that levels of utilization in early years are not indicative of the credits' potential long-run utilization because of the relative newness of the credit and taxpayers lack of familiarity with it.

Another proposed modification is to extend the 10-percent test to tax-exempt bond financed properties. It is asserted that it is difficult for any project to be placed in service in the same year that an allocation is received and that the rationale for the 10-percent test applies equally to bond financed and non-bond financed projects. Others counter that issuance of tax-exempt bonds prior to actual need represents a revenue drain on the U.S. Treasury.

b. Comparison of 70-percent versus 30-percent credits

Preliminary data indicates that while utilization of the credit is increasing, most transactions involve properties with no element of tax-exempt bond financing.

Two theories have been advanced as to the relative absence of bond-financed properties under the credit: (1) the restriction of bond-financed property to the 30-percent credit makes such projects relatively unattractive to investors; and (2) other general limitations on the use of tax-exempt bonds make their use in conjunction with the credit unlikely.

Proponents of the first theory argue that increased utilization of the credit by 70-percent projects, but not by 30-percent projects, in conjunction with the theory that the market operates efficiently, indicates that bond-financed property is relatively tax-disadvantaged. Others assert that increased demand for tax-exempt financing under the State volume cap and other restrictions are the reason why relatively little tax-exempt financing is available for use with the credit. No conclusive determination as to the relative accuracy of these theories has been made at this time.

c. Utilization of the nonprofit set-aside

Level of nonprofit set-aside

The Tax Reform Act of 1986 established an annual State allocation cap for the credit. The Act also required that 10 percent of each State's cap be set aside for the exclusive use by qualified nonprofit organizations. In addition to the mandatory set-aside, quali-

[9] Estimates of low-income housing credit activity for 1987, 1988, and 1989 prepared by the National Council of State Housing Agencies.

fied nonprofits may be allocated any additional amount of a State's remaining credit authority.

One issue associated with this provision is ascertaining the correct level of the nonprofit set-aside, assuming that such a set-aside is appropriate. While the theory behind the set-aside is to encourage involvement of nonprofits, the relative efficiency of a mandatory set-aside has not yet been determined.

Utility of the credit to nonprofits

Whatever is the appropriate level of involvement of nonprofits in credit properties, another issue presents itself. The issue is the utility of a tax benefit mechanism to a nontaxable entity. Currently, nonprofits form a partnership with taxable entities to participate in the tax credit projects, either directly or through taxable subsidiaries.

The structure of these deals and their relationship to the nonprofits requires further examination. Numerous proposals have been made to facilitate increased involvement of nonprofits in credit properties. They range from making the credit refundable to a series of proposals for special treatment of nonprofits under other tax provisions. Some argue that involvement of nonprofits is an essential element to the credit and express dismay at the relatively low utilization levels by nonprofits. Others respond that the credit should be structured to provide low-income housing in the most efficient way allowable under the Internal Revenue Code. In any event, further detailed study and information gathering is necessary for Congress to make an informed decision on the issue.

d. Utilization of the credit among the States

Experience among the States in utilization of allocation has varied; however, the general trend has been towards more complete utilization. In any effort to improve utilization through modification of the credit, at least three areas may deserve more attention: (1) activities of the allocating agency; (2) level of other subsidies by State and local governments; and (3) operation of the credit in rural and urban areas.

Activities of the allocating agency

Under the low-income housing credit, the allocating agency has sole responsibility for allocating credits in an amount not to exceed its credit cap. Any other rights and responsiblities of the agency have not been clearly delineated. There are proposals discussed above (see II. B.2.a. and b., above) to require allocating agencies to prepare allocation plans and perform project evaluations. Another alternative would be to have the agency take a more active rule in allocating the credit to more projects.

Some argue that there would be an appearance of impropriety if allocating agencies where to solicit project bids. The counterargument is that the operation of the allocating agency within certain safeguards may increase investor and developer awareness of the credit.

Level of subsidy by State and local governments

The credit was originally designed to be used to encourage low-income housing in conjunction with other State and local participation. In at least some instances, the credit must be used as a stand-alone subsidy simply because of lack of participation by State and local government. There is also some indication that in some areas the credit alone has not been enough to support the provision of low-income housing.

Rural/urban area utilization

There has been some discussion involving the relative utilization of the credit between rural and urban areas. The degree to which utilization differs between rural and urban areas may relate to relative median incomes or to other factors. One such factor is the operation of a low-interest loan program available in rural areas through the Farmers Home Administration. More complete discussion of these issues will be possible as more complete data are collected.

e. Ways to improve utilization

Level of subsidy

One way to improve investment in credit projects would be to increase the level of Federal tax benefits flowing to each project. Those who favor this approach argue that the benefit of the credit and other Federal tax provisions should be used to encourage participation by private investors in the provision of housing to low-income individuals. Others respond that the credit is not intended to provide the sole source of subsidy, but that ways should be developed to encourage other entities such as State or local governments to participate.

Allocating agencies

Some assert that the allocating agency should take a more active role in promoting use of the credit. This may be accomplished through some form of subsidy or penalty (or a combination thereof) intended to encourage participation by the allocating agency. Others respond that forces beyond the control of the allocating agency may be responsible for low utilization and in which case any subsidies or penalties would have little or even a detrimental effect.

Permanent extension and reduced complexity

Permanent or longer-term extension of the credit would provide more certainty in the market for investors. This certainty would encourage participation of more corporations and others who may be more risk averse. While a permanent extension may have this effect, Federal budget constraints lessen the possibility of such legislation. Indeed, utilization has increased rapidly nonetheless.

Some argue that significant reductions in the complexity in the credit would lead to increased and more efficient utilization. Others respond that, notwithstanding the complexity, each element of the credit represents an implementation of some Congressional policy.

4. Efficiency of the credit

a. Transaction and operating costs

Currently, the credit places no limits on the amounts of transaction and operating costs associated with a credit project. Examples of such costs are developers' fees, syndication fees, legal and engineering costs and management contracts. The Congress is concerned that the high level of such fees may limit the efficiency of the credit. In some instances transaction costs, including developers' fees, may approach 50 percent of total project costs.

Some argue that Congress should limit such transaction costs. Proposals include a definition of allowable costs or more simply a cap on total transaction costs. Opponents respond that competition in the market will control excessive costs and that an attempt by Congress to impose limits may be inappropriate to certain projects and generally may impinge on the flexibility of individuals to structure their deals.

b. Capitalization of fees

Generally, the eligible basis of an existing building includes its acquisition cost plus amounts chargeable to capital account and incurred by the taxpayer (before the close of the first taxable year of the credit period for such building) for property (or additions or improvements to property) of a character subject to the allowance for depreciation. The eligible basis for a new building is its adjusted basis. There is some indication that guidance is necessary to assist taxpayers in determining the eligible basis in credit property. Specifically the tax treatment of certain fees and transaction costs in relation to the credit may need clarification.

III. TAX CREDIT FOR REHABILITATION EXPENDITURES

A. Present Law

1. General rules for the rehabilitation tax credit

Present law provides an income tax credit for certain expenditures incurred in rehabilitating certified historic structures and certain nonresidential buildings placed in service before 1936. The amount of the credit is determined by multiplying the applicable rehabilitation percentage by the basis of the property that is attributable to qualified rehabilitation expenditures. The applicable rehabilitation percentage is 20 percent for certified historic structures and 10 percent for qualified rehabilitated buildings (other than certified historic structures) that were originally placed in service before 1936.

Eligibility for 10-percent credit

A nonresidential building that was originally placed in service before 1936 is eligible for the 10-percent rehabilitation credit only if the building is substantially rehabilitated and a specific portion of the existing structure of the building is retained in place upon completion of the rehabilitation. For this purpose, a building is considered substantially rehabilitated only if the qualified rehabilitation expenditures incurred during a 24-month period selected by the taxpayer exceed the greater of (1) the adjusted basis of the building as of the later of the first day of the 24-month period or the beginning of the taxpayer's holding period for the building, or (2) $5,000. In the case of any rehabilitation that is reasonably expected to be completed in phases set forth in architectural plans or specifications completed before the rehabilitation begins, a 60-month period is to be employed rather than the 24-month period.

A building satisfies the structural requirement only if (1) at least 50 percent of the existing external walls of the building are retained in place as external walls, (2) at least 75 percent of the existing external walls of the building are retained in place as internal or external walls, and (3) at least 75 percent of the existing internal structural framework of the building is retained in place. For purposes of this requirement, the internal structural framework of a building includes all load-bearing internal walls and any other internal structural supports, including columns, girders, beams, trusses, and spandrels, that are essential to the stability of the building.

Eligibility for 20-percent credit

A residential or nonresidential building is eligible for the 20-percent credit that applies to certified historic structures only if the building is substantially rehabilitated (as determined under the eli-

gibility rules for the 10-percent credit). In addition, the building must be listed in the National Register or the building must be located in a registered historic district and must be certified by the Secretary of the Interior as being of historical significance to the district. While the structural requirement that applies for purposes of the 10-percent credit is inapplicable to certified historic structures, the Secretary of the Interior is expected to deny certification in cases of substantial new construction rather than rehabilitation.

Definition of qualified rehabilitation expenditure

The income tax credit for rehabilitation expenditures is only available with respect to the the portion of the basis of the rehabilitated building that is attributable to qualified rehabilitation expenditures. A qualified rehabilitation expenditure is defined as any expenditure that is incurred in connection with the rehabilitation of a building which is eligible for the rehabilitation credit and that is properly chargeable to a capital account with respect to certain depreciable real property. A qualified rehabilitation expenditure, however, does not include the cost of acquiring a building or any interest in the building (such as a leasehold interest), the cost of facilities related to a building (such as a parking lot), or any expenditure that is attributable to the enlargement of an existing building.

In addition, an expenditure is not a qualified rehabilitation expenditure unless the amount of depreciation or cost recovery allowance with respect to the expenditure is determined under the straight line method. Finally, any expenditure incurred by the lessee of a building is not a qualified rehabilitation expenditure if on the date the rehabilitation is completed, the remaining term of the lease (determined without regard to any renewal periods) is less than the recovery period for the building (generally, 27.5 years for residential rental buildings and 31.5 years for nonresidential buildings).

Basis reduction and credit recapture

The basis of any property that is eligible for the rehabilitation credit is reduced by the full amount of the allowable credit. Consequently, no cost recovery allowance or depreciation deduction is allowed for rehabilitation expenditures that are considered funded by the rehabilitation credit.

In addition, the rehabilitation credit is subject to recapture (*i.e.*, the amount of income tax is increased by all or a portion of the credit) if the rehabilitated building is disposed of or otherwise ceases to be qualified investment property at any time during the five year period that begins after the year that the rehabilitated property is placed in service. For this purpose, a certified historic structure ceases to be qualified investment property if the Secretary of the Interior decertifies the structure.

2. Other applicable restrictions on the rehabilitation tax credit

a. At-risk rules

The investment tax credit at-risk rules apply to activities involving real estate where a credit is otherwise allowable, including the

rehabilitation credit. The investment tax credit at-risk rules limit the credit base of property. The rules generally provide that nonrecourse debt is treated as an amount at risk for credit purposes where (1) it is borrowed from an unrelated commercial lender, or represents a loan from or is guaranteed by certain governmental entities; (2) the property was acquired from an unrelated person; (3) the lender is not a person from whom the taxpayer acquired the property (and is unrelated to such a person); (4) the lender or a related person does not receive a fee with respect to the taxpayer's investment in the property; (5) the debt is not convertible debt and (6) the nonrecourse debt does not exceed 80 percent of the credit base of the property.

b. Restrictions on deductions and credits arising from passive activities

The rehabilitation credit, like the low-income housing credit, is subject to the limitation on losses and credits from passive activities with a $25,000 deduction equivalent allowance for credits from rental real estate activities. (This rule is discussed in more detail in II.A.2.b., above.)

c. Restrictions on use of credit to offset tax

The rehabilitation credit is subject to the rules of the general business credit (sec. 38), including the maximum amount of income tax liability that may be reduced by a general business credit in any one year. This limitation generally is equal to the excess (if any) of the taxpayer's net income tax over the greater of (1) the taxpayer's tentative minimum tax for the year, or (2) 25 percent of so much of the taxpayer's net regular tax liability as exceeds $25,000.

The rules for credit carryovers provide that unused credits for any taxable year may be carried back to each of the three preceding taxable years and then carried forward to each of the 15 following years.

B. Issues Relating to the Rehabilitation Tax Credit

Some argue that imposition of the passive loss restrictions, with the purpose of limiting abusive tax shelters, has curtailed rehabilitation activities. They argue that utilization of the rehabilitation credit has been limited to a degree greater than necessary to curb tax shelter activity, and point to the decline in utilization of the credit in recent years. Thus, they argue, the passive loss rules should be modified with respect to the rehabilitation credit.

Others have suggested that modifying the passive loss restrictions applicable to credit use would not increase actual rehabilitation activities with respect to old and historic structures. They argue that modifying the passive loss limitations on use of the credit by individuals with adjusted gross income over $250,000 would merely serve to create tax shelter opportunities for the wealthy. In addition, they point out that the rehabilitation credit is available, without the application of any passive loss restrictions, to widely held corporations.

IV. APPENDICES

A. Economic Issues Arising From Tax Preferences for Low-Income Rental Housing

As is the case with direct expenditures, the tax system may be used to improve housing opportunities for low-income families either by subsidizing rental payments (increasing demand) or by subsidizing construction and rehabilitation (increasing supply) of low-income housing units.

Excluding the value of Section 8 housing vouchers from taxable income is an example of a demand subsidy. By subsidizing a portion of rent payments, these vouchers enable beneficiaries to rent more or better housing than they might otherwise be able to afford. The low-income housing tax credit is an example of a supply subsidy. By offering a credit worth 70 percent of construction costs, it induces investors to provide housing which otherwise would not be built.

Efficiency of tax subsidies

Both direct expenditures and tax subsidies for rental payments may not increase housing consumption dollar for dollar. One study of the Section 8 Existing Housing Program suggests that, for every $100 of rent subsidy, a typical family increases its expenditure on housing by $22 and increases its expenditure on other goods by $78.[10] While the additional $78 spent on other goods certainly benefits the family, the $100 rent subsidy does not increase their housing expenditures by $100.

The theory of subsidizing demand assumes that, by providing low-income families with more spending power, their increase in demand for housing will ultimately lead to more or better housing being available in the market. However, if the supply of housing to these families does not respond to the higher market prices that rent subsidies ultimately cause, the result will be that all existing housing costs more, the low-income tenants will have no better living conditions than before, and other tenants will face higher rents. The benefit of the subsidy will accrue primarily to landlords because of the higher rents.

Supply subsidy programs can suffer from similar inefficiencies. If a developer had planned to build low-income rental units prior to the creation of the low-income housing tax credit, the developer may now find that the project qualifies for the credit. That is, the subsidized project may displace what otherwise would have been an unsubsidized project with no net gain in number of low-income housing projects. If this is the case, the tax expenditure of the

[10] *See*, W. Reeder, "The Benefits and Costs of the Section 8 Existing Housing Program," *Journal of Public Economics*, 26, 1985.

credit will result in little benefit except to the extent that the credit's targeting rules may force the developer to serve lower-income individuals than otherwise would have been the case.

One study of government-subsidized housing starts between 1961 and 1977 suggests that as many as 85 percent of the government-subsidized housing starts may have merely displaced unsubsidized housing starts.[11] This figure is based on both moderate- and low-income housing starts, and therefore may overstate potential inefficiency of tax subsidies for low-income housing. Displacement is more likely to occur when the subsidy is directed at projects the private market would have produced anyway.[12] Displacement is also more likely to occur if the number of subsidies granted is small relative to private market activity because there is more possibility for substitution. Thus, if relatively small private market activity exists for low-income housing, a supply subsidy is more likely to produce a net gain in available low-income housing units because the subsidy is less likely to displace otherwise planned market activity.

Many believe that tax-based supply subsidies do not produce significant displacement within the low-income housing market because they believe that low income housing is unprofitable and the private market would not otherwise build new housing for low-income individuals. Under this theory, tax-subsidized low-income housing starts would not displace unsubsidized low-income housing starts.

The tax subsidy for low-income housing construction could displace construction of other housing. Constructing rental housing requires specialized resources. A tax subsidy for low-income housing may induce these resources to be devoted to the construction of low-income housing rather than other housing. If most of the existing low-income housing stock originally was built to serve nonlow-income individuals, a tax subsidy to low-income housing could displace some privately supplied low-income housing in the long run.

Targeting the benefits of tax subsidies

Since the basic principle of demand subsidies is to put more cash in the hands of consumers, targeting the recipients of the subsidy is not a difficult job. For example, the use of a tax deduction or tax credit could be limited to individuals whose income is less than some specified amount. However, such demand-side tax subsidies are not without problems for targeting recipients.

If a low-income tax subsidy is structured as a tax deduction, many low-income individuals might not be able to take advantage of the subsidy. Utilizing a tax deduction requires taxable income, and the Tax Reform Act of 1986 eliminated any tax liability for many low-income families. Even if the tax subsidy were structured as a credit, the credit would have to be refundable (i.e., the credit would have to be payable without regard to tax liability) for any of

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[11] *See* M. Murray, "Subsidized and Unsubsidized Housing Starts: 1961-1977," *The Review of Economics and Statistics*, 65, November 1983.

[12] For example, a mortgage subsidy for single-family housing may be a ready substitute for conventional mortgages available in the private market place. The effect of the subsidized mortgage may be to reduce the supply of unsubsidized mortgages since the money is borrowed from the same pool of private investors.

the potential benefits to reach low-income families who have no tax liability.[13] Even if the credit were refundable, some low-income families either may not file tax returns or may not be aware of their eligibility for the credit and, as a result, the potential benefits could go unclaimed. A refundable demand-side tax credit would have to be payable more frequently than annually to assist low-income taxpayers in meeting rent commitments. A refundable credit would require creating a distribution system to get the funds in the hands of the recipients, which could present significant administrative difficulties, particularly if the recipient were unemployed.[14] Thus, some might contend that a demand subsidy may be administered most efficiently as a spending program (e.g., Section 8 vouchers) rather than through the tax system.

Credits versus deductions

A tax subsidy may be structured as either a deduction or a credit. Deductions yield different dollar amounts of tax benefits depending upon the taxpayer's marginal tax rate. In the case of a demand subsidy, as a taxpayer's income and marginal tax rate increases, the tax subsidy provided to the taxpayer also increases because each dollar of deduction offsets a dollar of income that would have been taxed at a higher marginal tax rate.

In the case of a supply subsidy in the form of a deduction, if both a higher tax bracket and a lower tax bracket supplier find it profitable to use the deduction and provide low-income housing, the lower tax bracket supplier will have supplied the housing at less cost to the government, even though both suppliers provide the same amount of housing. For the same dollar amount of deduction, the higher tax bracket supplier of housing receives more dollars of tax benefit than the lower tax bracket supplier.

Tax credits yield the same dollar of tax benefit to all recipients and therefore do not favor higher income taxpayers. [15] Thus, the low-income housing credit yields the same tax benefit to all investors.

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[13] Refundable tax credits (other than the earned income credit) are treated as direct outlays in the budget process.

[14] The earned income credit is payable to the employee in his paycheck.

[15] This is not strictly true if a taxpayer has an insufficient tax liability to utilize fully the credit and the credit is not refundable.

B. Overview of Federal Low-Income Rental Housing Assistance Programs

1. Legislative background of direct expenditure programs

Pre-1974 legislation

Federal participation in the provision of low-income rental housing began with the United States Housing Act of 1937.[16] This law provides Federal assistance for the construction of low-rent projects which were developed, owned and operated by State-chartered, local public housing agencies. Federal assistance is given by annual payments made under an annual contributions contract. The subsidy covers the payment of annual interest and amortization of bonds or notes issued by the public housing agency.[17] In response to inflation in the 1960s, tenant rent payments were limited to no more than 25 percent of income and the Department of Housing and Urban Development (HUD) was authorized to pay operating costs of projects to make up for the loss of income incurred by the public housing agency because of the limitation on rent payments.

Section 221(d)(3)

The Housing Act of 1937 established the Section 221 mortgage insurance program providing assistance for construction and rehabilitation of housing for displaced persons. This assistance was extended to low- and moderate-income families in the Housing Act of 1961 when the program was extended beyond mortgage insurance to the subsidization of mortgage interest charges.

Section 202

Efforts to broaden the number of people served by the 1937 Act led to other assistance programs being added through time. These assistance programs generally relied upon reducing the financing costs of new construction. For example, Section 202 of the Housing Act of 1959 provided direct loans for construction of rental units for elderly families. Construction and permanent financing loans are given for the development of rental units. As revised through the years, this program was expanded to include low-income handicapped persons and their families.

Section 236

In 1968, the Section 236 program was enacted to provide subsidies to developers of rental units. These subsidies were provided in

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[16] For a more complete discussion of these programs, *see*, G. Milgram, *Housing Assistance: A Brief History and Description of Current HUD Programs*. Congressional Research Service, Report 88-385E, May 19, 1988.

[17] In more recent years, HUD has been authorized to pay development costs through grants at the beginning of development, rather than through annual payments.

the form of an annual interest payment to the private lender which reduced the effective rate of mortgage interest to one percent. Eligibility for residency in an assisted rental project was limited to families with incomes below 135 percent of maximum income for admittance to public housing in the particular area. Families then paid at least 25 percent of income for rent. A higher payment would be necessary if the interest reduction was insufficient to lower rents to an amount that could be covered by the 25 percent figure. Section 236 assistance superseded the similar section 221(d)(3) program.

In the early 1970s these housing programs came under criticism for being excessively expensive in both initial construction costs and operating expenses, and subject to unacceptably high rates of default and foreclosure. In response to the criticism, a moratorium on all new activities under the major subsidy programs was imposed after January 5, 1973. Since that time, no additional units have been financed with Section 236 rental housing assistance, although long-term contracts continue to be honored.

1974 Act—"Section 8"—program

The Housing and Community Development Act of 1974 created a new program popularly referred to as "Section 8." This law amended Section 8 of the Housing Act of 1937 to provide a payment made by HUD on behalf of the tenant to a landlord. The tenant must receive a certificate of eligibility from the local public housing agency and must find his or her own housing. The payment to the landlord is the difference between the tenant's rent payment, which is limited to 30 percent of the tenant's income, and the contract rent. The contract rent generally may not exceed the HUD established fair market rent. The law permits the subsidy amount to increase annually as rents in the local area increase.

1983 Act

Prior to the Housing and Urban-Rural Recovery Act of 1983, section 8 housing units could be either in existing housing, or in new construction or substantially rehabilitated units which were built under a commitment from HUD that Section 8 subsidies would be paid to eligible tenants when development was completed. The 1983 Act removed authorization for additional new construction or substantial rehabilitation.

Housing vouchers

A housing voucher program was adopted in 1983 as a demonstration program. The housing voucher program is technically a part of the Section 8 program and is similar to the Section 8 Existing Housing (Certificate) Program in providing a subsidy for rent payments to landlords on behalf of tenants. In the voucher program, HUD pays the difference between 30 percent of the tenant's income and the HUD- established fair market rent. Unlike the Section 8 certificates, the tenant and landlord establish the contract rent, which may exceed the fair market rent. Consequently, the tenant may pay more than 30 percent of his income in rent.

Section 17

The 1983 Act created Rental Housing Rehabilitation and Production Grants. The rehabilitation part of the program provides grants for moderate rehabilitation of units in neighborhoods in which the median income is not greater than 80 percent of the area median income. The grant may finance no more than 50 percent of all costs and cannot exceed $5,000 per unit. Rehabilitations are restricted to correct substandard conditions, make essential improvements, or repair major systems in danger of failure. All assistance must benefit low-income families.

The program also makes available grants for new construction and substantial rehabilitation. Demonstration of a shortage of affordable rental housing, minimization of displacement, and contribution to neighborhood conservation constitute some of the many selection criteria.

Farmers Home Administration programs

In addition to programs administered by HUD, the Department of Agriculture, through the Farmers Home Administration ("FmHA"), provides rental housing assistance primarily targeted to rural areas.[18]

Section 515

The Senior Citizens Housing Act of 1962 amended the Housing Act of 1949 by adding Section 515. Under Section 515, FmHA makes loans to developers of rental housing at a one-percent interest rate, repayable over 50 years. The assisted housing must be located in rural areas and must be made available to low- and moderate-income families at affordable rates.

Section 521

In 1968, Section 521 was added to the Housing Act of 1949 to enable FmHA to make loans available to nonprofit developers of rural, rental housing The loans may be originated with interest rates as low as one percent.

In 1974, Section 521 was amended to authorize FmHA to provide rental assistance payments to owners of FmHA-financed rental housing. Amendments in 1983 provided that the rent payments made by eligible families would be the greatest of (1) 30 percent of monthly adjusted family income, (2) 10 percent of monthly income, or (3) for welfare recipients, that portion of the family's welfare payment that is designated for housing costs. FmHA pays the rental assistance payments directly to the borrowers to make up the difference between the tenants' payments and the FmHA- approved rent for the units. The term of the rental assistance agreement is 20 years for new construction and 5 years for existing projects.

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[18] For a more complete discussion of FmHA programs, *see*, B. E. Foote, *Rural Housing Programs of the Farmers Home Administration: Brief Descriptions and Budget Data*, Congressional Research Service, Report 87-171E, March 3, 1987.

Uniform requirements

As different programs were added in a piecemeal manner, different programs often had different eligibility or rent requirements. Now the requirements are uniform across programs. Eligible tenants must have incomes under 80 percent of the median income in the local housing market, adjusted for family size. The tenant's out-of-pocket contribution toward rent, which includes both payment for shelter and utilities, cannot exceed 30 percent of income.

2. Scope of Federal housing programs; rehabilitation tax credits

HUD programs

While the growth in the number of assisted housing units has slowed during the 1980s, there were nearly 1 million more assisted housing units at the end of 1988 than in 1980. The total stock of HUD-assisted housing is in excess of 4 million units. Table 1 reports the stock of HUD-assisted housing by program type. Section 8 is the program that provides the largest number of assisted units. By the end of fiscal 1988, over 2.3 million households received assistance through receipt of a Section 8 subsidy payment. More than half of these were in the existing housing program. Conventional public housing currently houses some 1.25 million families.[19]

[19] G. Milgram, *Urban Housing Assistance Programs in the United States*, Congressional Research Service, Report 89-137E, March 2, 1989.

Table 1.—Stock of HUD-Assisted Housing Units by Program, Selected Fiscal Years 1955–1988

[Number of units in thousands]

End of fiscal year	Net total	Section 236 units with Section 8 or rent supp.	Gross total	Public housing[1]	Rent supp.	Section 235	Section 236	Section 8 (including voucher)
1955	414	NA	414	414	NA	NA	NA	NA
1960	477	NA	477	477	NA	NA	NA	NA
1965	605	NA	605	605	NA	NA	NA	NA
1970	967	NA	967	865	31	66	5	NA
1975	2,126	NA	2,126	1,151	165	409	400	NA
1980	3,268	NA	3,268	1,192	165	219	538	1,153
1981	3,297	161	3,458	1,204	158	241	537	1,319
1982	3,508	174	3,682	1,224	153	542	537	1,527
1983	3,631	208	3,840	1,250	77	230	533	1,780
1984	3,860	178	4,038	1,332	56	209	531	1,910
1985	3,943	196	4,140	1,355	46	199	528	2,010
1986	4,077	192	4,269	1,380	34	182	529	2,143
1987	4,151	189	4,341	1,390	23	158	528	2,240
1988	4,233	203	4,435	1,398	23	148	528	2,338

NA: Not applicable.
[1] Excluding Indian housing.

Source: G. Milgram, *Urban Housing Assistance Programs in the United States*, Congressional Research Service, Report 89-137E, March 2, 1989.

Tables 2 and 3 show that expenditure on and growth of public housing has slowed considerably over the past 10 years. Table 2 reports annual additions to the assisted housing stock. Section 8 is the program currently adding the most units to the subsidized housing stock, although at a lower rate than in previous years. Housing vouchers are funding larger proportions of Section 8 assistance. In fiscal year 1986, 36,000 of the units were assisted by vouchers, and funding plans call for 48,500 vouchers for fiscal 1989. Over the same period, the authorizations for Section 8 certificates have dropped from 39,000 to 18,333.[20] Table 3 documents the decline in expenditure on the Section 8 and other housing programs.

Table 2.—Newly Reserved Units in Public Housing and Section 8 Assistance, Fiscal Years 1977–1988

[Number of units in thousands]

Fiscal year	Total [1]	Total NC&SR [2]	Total existing	Section 8		Public housing, NC&SR [2]
				NC&SR [2]	Existing	
1977	362.9	201.3	161.6	169.4	161.6	31.9
1978	313.9	178.4	135.5	122.0	135.5	56.3
1979	324.7	200.0	124.7	145.0	124.7	54.9
1980	205.9	129.4	76.5	97.8	76.4	36.7
1981	220.1	109.8	110.3	73.9	110.3	35.9
1982	145.5	39.6	105.9	27.5	105.9	12.1
1983	146.7	18.1	128.6	15.6	128.6	2.5
1984	151.7	21.8	129.9	14.4	129.9	7.4
1985	125.5	20.3	105.2	12.6	105.2	7.6
1986	106.3	16.9	89.4	11.5	88.7	6.1
1987	99.6	21.2	78.5	12.6	77.5	9.8
1988	92.6	20.7	71.9	11.3	70.7	9.4

[1] Until fiscal 1980, units reserved are reported on a net basis, exclusive of units recaptured from previous reservations. In fiscal 1981 and thereafter, the data are on a gross basis.

[2] New construction and substantial rehabilitation.

Source: G. Milgram, *Trends in Funding and Numbers of Households in HUD-Assisted Housing, Fiscal Years 1975–1989*, Congressional Research Service, Report 89-200E, March 9, 1989, and G. Milgram, *Trends in Funding and Numbers of Households in HUD-Assisted Housing, Fiscal Years 1975–1988*, Congressional Research Service, Report 88-340E, May 31, 1988.

[20] *Ibid.*

Table 3.—Use of Budget Authority for Public Housing and Section 8 Assistance, Fiscal Years 1977–1988

[Dollar amounts in billions]

Fiscal Year	Total [1]	Total NC&SR [2]	Total existing	Section 8		Public housing, NC&SR [2]
				NC&SR [2]	Existing	
1977	$27.8	$21.8	$6.0	$18.9	$4.9	$3.0
1978	25.3	19.8	5.5	13.3	4.8	6.4
1979	28.2	23.1	5.1	16.4	5.1	6.7
1980	19.3	15.2	4.1	10.7	4.1	4.5
1981	21.0	14.9	6.1	10.2	6.1	4.7
1982	10.3	5.4	4.9	3.7	4.9	1.7
1983	8.6	2.3	6.3	2.0	6.3	0.3
1984	8.1	3.1	5.0	1.9	5.0	1.2
1985	7.8	2.7	5.1	1.5	5.1	1.2
1986	7.3	2.8	4.5	1.6	4.5	1.2
1987	5.4	2.3	3.1	1.6	3.1	0.7
1988	5.5	2.2	3.3	1.5	3.3	0.8

[1] Until fiscal 1980, units reserved are reported on a net basis, exclusive of units recaptured from previous reservations. In fiscal 1981 and thereafter, the data are on a gross basis.

[2] New construction and substantial rehabilitation.

Source: G. Milgram, *Trends in Funding and Numbers of Households in HUD-Assisted Housing, Fiscal Years 1975–1989, supra.*, and G. Milgram, *Trends in Funding and Numbers of Households in HUD-Assisted Housing, Fiscal Years 1975–1988*, Congressional Research Service, Report 88-340E, May 31, 1988.

Loans under Section 202 have typically been combined with assistance under Section 8. Loans under Section 202 have also dwindled in recent years. In fiscal 1981, permissible loan funds reached their peak of $895.8 million. In fiscal 1988, loan funds were limited to $565.8 million. Nevertheless, by the end of fiscal 1988, more than 150,000 units had been completed with the assistance of Section 202 funds in concert with Section 8.

Approximately 600,000 units were built under the Section 236 program of which 528,000 units remain in the program. Of this total, 203,000 receive Section 8 assistance. Another approximately 70,000 units are in service with the assistance of Section 221.

FmHA programs

The current stock of FmHA-assisted housing is approximately 350,000 units under the Section 515 program. A decade earlier the stock of such housing was 160,000 units. Between 1978 and 1988, the number of units assisted under Section 521 has grown from a total of 20,000 units to nearly 150,000 units. Tables 4 and 5 document the activity of the FmHA in providing assisted rental housing in recent years. As with the HUD programs, the number of net new additions to the FmHA-assisted housing stock has declined in

recent years. It is important to note that the assisted units reported in Table 5 under the Section 521 program are not in addition to those of Section 515, but rather generally represent a subset of those assisted under Section 515.[21]

Table 4.—Net New Additions to Assisted Housing Stock Loan Obligations and Units Assisted Under Section 515, Fiscal Years 1977–1987

[Dollars in millions]

Fiscal year	Loan obligations	units
1977	$555	32,056
1978	676	34,300
1979	870	38,650
1980	881	33,100
1981	865	29,500
1982	954	30,500
1983	802	24,200
1984	919	27,100
1985	903	25,687
1986	652	21,266
1987 (estimate)	670	21,233

Source: B.E. Foote, *Rural Housing Programs of the Farmers Home Administration: Brief Descriptions and Budget Data*, Congressional Research Service, Report 87-171E, March 3, 1987.

Table 5.—Net New Additions to Assisted Housing Stock Units Assisted Under Section 521, Fiscal Years 1977–1987

Fiscal year	Units
1978	20,000
1979	22,623
1980	20,000
1981	17,655
1982	14,280
1983	11,746
1984	10,750
1985	15,250
1986	14,511
1987 (estimate)	14,511

Source: B.E. Foote, *Rural Housing Programs of the Farmers Home Administration: Brief Description and Budget Data, supra.*

[21] Section 521 rental assistance also may be provided to farm laborers who live in housing financed under the FmHA Section 514 program for farm laborers.

Rehabilitation tax credits

The number and dollar value of rehabilitation projects utilizing rehabilitation tax credits has declined in recent years. The number of rehabilitation projects approved by the Department of the Interior grew steadily from 635 projects in fiscal year 1979 to 3,214 in fiscal year 1984. Since 1984 the number of approved rehabilitation projects has declined, falling to 3,117 in fiscal year 1985, to 2,964 in fiscal year 1986, to 1,931 in fiscal year 1987, and to 1,092 in fiscal year 1988.[22]

Concomitantly with the rise in project approvals in the late 1970's and early 1980's, the dollars of private investment committed to rehabilitation projects increased from $.3 billion in fiscal year 1979 to a peak of $2.4 billion in fiscal year 1985. The private dollars invested in rehabilitation projects has fallen in each of fiscal years 1986, 1987, and 1988. In 1986, the total was nearly $1.7 billion. In 1987, the total was $1.1 billion. And, in 1988, the total was approximately $.9 billion.[23] The number of projects and the total investment dollars for fiscal year 1988 exceed the total 1980 levels.

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[22] Betsey Chittenden, *Tax Incentives for Rehabilitating Historic Buildings: Fiscal Year 1988 Analysis*, Preservation Assistance Division, National Park Service, Department of the Interior, November 1988.

[23] *Ibid.*